

Leadership in a post-merger context: the importance of people skills over politics

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Leadership in a post-merger context

The importance of people skills over politics

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Abstract

Drawing on the merger and CEO succession literature as well as on findings from research on organizational change, this study examines what leadership issues drive success in a post-merger context. Our data from 45 recently merged units within a cooperative bank in Europe indicate that the people skills of the newly appointed top manager matter most. Specifically, his/her integration ability followed by the ability to positively influence the internal working environment are significantly correlated with post-merger success. Politics in terms of whether the top manager had a track record inside or outside the organization did not appear to be important.

Key words: Merger, leadership, CEO succession.

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Abstract

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Introduction

Reports from financial analysts, media and surveys continually indicate that most mergers fail and many studies have sought answers to the question why (Epstein, 2004). Although failure can partly be explained by financial, market and strategic factors, the role of the implementation process should not be underestimated (Marks and Mirvis, 2001; Schuler and Jackson, 2001; Pablo and Javidan, 2002; Epstein, 2004). Since a merger entails the blending of two formerly independent organizations, it represents sudden and major change to an organization (Cartwright and Cooper, 1990). When analyzing the organizational change literature it becomes apparent that previous research on the success of organizational change has shown that reorganization attempts are more often than not ineffective (Sorge and Van Witteloostuijn, 2004). Working in a post-merger context thus appears to be an especially inflammable environment and the question emerges what leaders can do – if anything – to beat these statistics.

Historically the leadership literature has been divided on whether leaders can influence organizational performance. One school of thought rooted in organizational ecology argues that environmental forces determine the success or failure of organizations (Pfeffer and Salancik, 1978; Aldrich, 1979). Empirical studies in this tradition have in general failed to find performance variations that could be attributed to leadership factors (Rowe et al, 2005). The leader in this view is thus inconsequential or at best a phenomenological concept created by organizational members to understand the complexity of causalities in the world around them (Meindl and Ehrlich, 1987).

Another school of thought – based on the importance and impact of strategic choice (Child, 1972) – argues exactly the opposite. Through their strategic actions, leaders can have a significant effect on the performance of the organization and thus do matter (Chatterjee, Lubatkin and Schulze, 1999; Boal and Hooijberg, 2000). Many empirical studies have been

conducted within perspectives building on these assumptions such as the ‘upper- echelon perspective’ (Hambrick and Mason, 1984) or strategic leadership theory (Cannella and Monroe, 1997). Empirical results have been mixed, however, leading to a plea for the incorporation of longitudinal factors (Boal and Hooijberg, 2000; Rowe et al., 2005) and a consideration of the contingency factors involved (Lin and Li, 2004).

Our contribution to this debate is threefold. First, we incorporate longitudinal data with respect to organizational performance in our study allowing us to investigate time effects of leadership on organizational performance as suggested by Rowe et al. (2005). Second, we incorporate contingency factors by studying leadership in a specific post-merger context following suggestions by Lin and Li (2004) and thirdly, we go beyond the question of whether the leader affects performance by also examining the nature of the leadership issues that drive success.

In the next section we briefly review studies addressing the question what impact leaders actually have on the organization. We focus on succession research as these studies specifically address the context of change and transition. The following section then refers to the post-merger context. The main questions explored are: what makes this context specific and what are the drivers for success in such an environment? Subsequently our framework for analysis as well as our hypotheses is presented, followed by a discussion of the methodology and the results. In the final section we discuss our results and draw conclusions.

The impact of the leader: lessons from succession research

Following the views on the importance of leadership outlined in the introduction there are three perspectives on the impact of a succession event on the performance of an organization (Friedman and Singh, 1989). The first perspective – referred to as common-sense theory (Grusky, 1963) - sees succession as a means to adapt to changing conditions in the

environment and is thus viewed as having a positive impact on performance (Dalton and Kesner, 1985). The rationale behind this reasoning is that top management can facilitate the translation of external information to organizational members and thus reduce conflict. In this way, the organization will be better aligned to the environment and be able to better perform (Lin and Li, 2004). Some empirical studies in this tradition reveal that between 20 and 45% of performance variance can be attributed to the succession event (Day and Lord, 1988).

The second point of view – called the vicious circle theory (Grusky, 1960) - argues that succession has a disrupting effect on existing work routines and structures resulting in a negative impact on performance. The resulting conflict and lowered morale following a succession will further reduce organizational effectiveness and ultimately lead to further changes in leadership (Rowe et al., 2005).

The third group of studies finds succession an inconsequential event that has no impact at all. According to this point of view, replacing a person in charge is just a symbolic political action, a form of ritual scapegoating (Gamson and Scott, 1964; Boeker, 1992).

Although empirical succession studies have yielded support for all three perspectives (Kesner and Sebor, 1994), the main conclusion to be drawn from previous studies is that the field is very fragmented with little attention to organizational and environmental contextual variables that could help explain the difference in findings (Lin and Li, 2004). Furthermore, the question of timing has been insufficiently addressed. According to Rowe et al. (2005) it takes time for a new leader to become familiar with the organization in order to develop organization-specific skills. Furthermore, drawing on the organizational learning literature, they claim it takes time for the organizational members to learn and implement the new direction. Any performance improvements can thus only be seen after sufficient time has elapsed. Time compression diseconomies (Dierickx and Cool, 1989) even suggests that by

trying to shorten the time available for learning organizational specific knowledge, diseconomies will occur resulting in worse performance.

Next to time, one of the most important contextual variables to consider is successor origin (Kesner and Sebor, 1994; Lin and Li, 2004). Many studies (e.g. Zajac, 1990; Virany et al., 1992; Shen and Cannella, 2002) find that firms with insider CEOs tend to be significantly more profitable than firms with outsider CEOs. Insider succession is associated with continuity, greater loyalty and thus with a small disruptive effect (see for example Boeker & Goodstein, 1993; Lauterbach, Vu and Weisberg, 1999). Furthermore, information asymmetries between the Board and outside candidates about the characteristics of the CEO create adverse selection problems (Zajac, 1990). As a result, 'a Board's decision to hire an outside CEO will, on average, be a worse decision (in terms of performance implications) than a Board's decision to hire an insider CEO' (Zajac, 1990: 220). Externally recruited managers may also lack the internal social and political network and knowledge of the organizational systems (Virany et al., 1992; Shen and Cannella, 2002). As a result they may have difficulty implementing change. This suggests the importance of another contingency factor to consider, namely the strategic objective to be achieved. If change is the strategic objective of the organization, outsider succession is often seen as a mean to induce this in the organization, as outsiders are not bonded to organizational politics and established social norms set by the former CEO (Friedman and Saul, 1991). The induction of radical change does, however, not necessarily need to lead to improved performance. Other studies have demonstrated that these actions also take place for symbolic reasons (Boeker, 1992) implying that the determination of successor type is more a political process than one geared towards performance improvements (Lin and Li, 2004).

In addition to organizational contingency factors, environmental factors are important in explaining performance differences. Lin and Li (2004) demonstrated the importance of

industry environment, next to the importance of successor type in determining the performance consequences of top management successions. Therefore, the next section examines the specific context in which this study took place.

The post-merger context

Mergers are a popular method of organizational growth and development since they allow firms to compete in ways they would not have been able to alone (Pablo and Javidan, 2002). The specific objective of the merger depends on the type. Horizontal mergers – in which two related organizations are joined – are aimed at gaining economies of scale. By joining forces they aim to better exploit existing core competences resulting from the increase in size. Vertical mergers – which involve two unrelated organizations – should help gain economies of scope (Boot and Schmeits, 1999). In this case firms might get access to resources, capabilities and markets that they would not independently control (Pablo and Javidan, 2002). Whether these synergies are indeed attained depends on how well the different stages of the merger are managed.

During a merger four stages can be distinguished: the planning phase, the anxious phase, the merger phase and the evaluation phase (Graves, 1981). Although each phase is important, most research to date has focused on the first three phases which deal with the strategic vision and fit, negotiation, the deal structure, due diligence and pre-merger planning (e.g. Shrivastava, 1986; Cartwright and Cooper, 1990). Much less is known about what happens in the implementation and evaluation phase (Epstein, 2004). This phase is characterized by realizing the possible synergies that have been identified in the pre-merger phases through knowledge building, relationship building and effective transition management (Marks and Mirvis, 2000). So it is during this phase that the value creation attributed to the merger should take place (Birkinshaw, Bresman and Håkanson, 2000). This

is partly a matter of strategic intent – defining and realizing who contributes what, when – but even more of organizational alignment. In the alignment phase the formerly independent organizations are integrated through attention to culture and organizational processes of decision-making, communication and trust-building (Schweiger and Weber, 1989; Cartwright and Cooper, 1990; Pablo and Javidan, 2002).

We will focus on this post-merger context: the physical integration between the organizations already took place and it is up to a new leader to effectively guide and integrate the new organization. According to Shrivastava (1986), integration takes place at three levels: procedural, physical and socio-cultural. Procedural integration involves combining systems and procedures of the merged companies with the objective to homogenize and standardize work processes. Physical integration involves the consolidation of product lines, plant and equipment and real estate assets. Finally, socio-cultural integration involves issues related to cultural and people aspects, as well as to the establishment of new leadership. Essential tasks of the new leader are selecting, retaining and motivating key employees and managing the communication process with all stakeholders. This is regarded as the key process to merger success (Schuler and Jackson, 2001). Although it is less of a problem to integrate accounting systems, processes and physical assets, integrating the former cultures and the people is a tough job (Ashkanasy and Holmes, 1995; Covin, Kolenko, Sightler and Tudor, 1997; Marks, 1997; Daniel, 1999; Epstein, 2004).

Leadership in a post-merger context: six hypotheses

Integrating the logic expressed in the previous two sections, a model of the proposed relationships between aspects of leadership and post-merger performance is presented in Figure 1. The discussion on the impact of leadership and the lessons learned from succession research are incorporated into the political aspect of leadership: *who* will be the next leader?

The leadership issues specific to the post-merger context are addressed by the people skills: *what* should a leader in that specific context do particularly well? The issue of timing is addressed by assessing organizational performance at four different moments in time.

INSERT FIGURE 1 ABOUT HERE

The argumentation underlying the relationships and the specific hypotheses are provided below.

As was discussed in the previous section, socio-cultural integration is considered crucial for the success of a merger (Epstein, 2004). The failure of a merger is thus often attributed to a lack of attention to cultural integration and human resource issues (Mark, 1997; Bourantas and Nicandrou, 1998; Schuler and Jackson, 2001). The rationale behind this line of reasoning is the following (Veiga et al., 2000): when an employee has a good fit with the existing organizational culture, it becomes part of the employee's identity. In other words, the person-culture fit is high. Given the research findings that indicate that organizational culture is an important determinant of an individual's commitment, satisfaction, productivity and longevity within a group or organization, failing to address a change in person-culture fit can have severe consequences. Employees may lose commitment and refuse to cooperate, resulting in negative behaviour. These negative behaviours in turn influence performance negatively (Cartwright and Cooper, 1990).

Furthermore, following the arguments put forward by Rowe et al. (2005), even if the socio-cultural integration is successful this will not immediately be associated with improved post-merger performance. The new leader as well as the organizational members need time to get acquainted with the new culture and to learn the new rules and routines. This leads to our first hypothesis:

Hypothesis 1: As time progresses, successful socio-cultural integration and post-merger performance are positively related

Next to the importance of socio-cultural integration, the internal working environment within the new organization is important. Because the merger represents sudden and major organizational change, it will lead to stress and uncertainty among employees. If an organization does not have strategies in place to help cope with this uncertainty, it is very likely to result in negative employee behaviour such as lowered morale, job dissatisfaction, acts of sabotage, lower productivity, increased turnover and absenteeism rates (Cartwright and Cooper, 1990; Ashkanasy and Holmes, 1995). These negative behaviours have a negative effect on post-merger performance. So, the internal environment needs to be managed such that satisfaction and productivity increase, while at the same time turnover and absenteeism decrease for the merger to be successful.

As in hypothesis 1, we also expect a time effect in hypothesis 2 for the same reasons offered previously. This leads to our second hypothesis:

Hypothesis 2: As time progresses, an improvement in the internal working environment and post-merger performance are positively related

Since building a positive internal working environment is an essential part of successful integration, we also expect socio-cultural integration and the internal working environment to be related. Previous research suggests significant drops in employee productivity and employee satisfaction and severe increases of leadership turnover and loss of key employees,

when poor integration occurs (Schuler and Jackson, 2001). This generates the third hypothesis:

Hypothesis 3: Successful socio-cultural integration and an improvement in the internal environment are positively related.

The first three hypotheses address which people skills might be positively associated with post merger performance (the *what* of leadership). The following three hypotheses provide an additional perspective by examining issues related to the politics involved: does it make a difference for post-merger integration, managing the internal environment and post-merger performance, whether the leader comes from inside or outside the organization (the *who* of leadership)? This variable to characterize the top manager is considered especially important in a post-merger setting since the choice for an insider or outsider CEO reflects the direction and strategy the organization wishes to take in the future (Boeker and Goodstein, 1993). Epstein (2004) argues that one of five factors driving merger success is the presence of a clear integration strategy ‘that reinforces that this is a ‘merger of equals’ rather than an acquisition’ (p. 176). This makes the political component associated with succession type in this setting very important: the choice of an outsider signals to the people of the organization that a new organization with integrated policies and a new integrated culture will be built out of the two separate entities. Knowledge from either one of the previous entities is neither necessary nor desirable. Furthermore, as it is assumed that insiders have more difficulty to let go of the organizational policies and culture that they are acquainted too, it is assumed that insiders have more difficulty in integrating two or more former independent organizations than outsiders. This leads to the fourth hypothesis:

Hypothesis 4: In a post-merger context, an insider CEO is less successful in socio-cultural integration than an outsider CEO

The same reasoning applies to generating improvement in the internal environment of the new organization. Having a history in one of the previous entities is a disadvantage in this context since it may be viewed as one entity wanting to acquire the other rather than merging on an equal foot. This generates our fifth hypothesis.

Hypothesis 5: In a post-merger context, an insider CEO will generate less improvement in the internal environment than an outside CEO

In line with the argument that outside leaders are better able to initiate change (Goodstein & Boeker, 1991; Wiersema, 1992; Haddadj, 1999), it is proposed that outsiders will thus be able to facilitate the organization's response to the environmental changes which are caused by the merger and overcome any inertial forces that might exist (Singh, House and Tucker, 1986). This results in hypothesis 6.

Hypothesis 6: In a post-merger context, an insider CEO will generate lower post-merger performance than an outsider CEO

Methodology

Sample and data collection

The data reported in this research are from a sample of 45 European¹ cooperative banks which merged between 1997 and 2002. These cooperative banks are part of the same organization, thereby minimizing the effect of the environment on performance and maximizing the comparability between banks.

We constructed our sample by sending a questionnaire to the CEO's of all the 105 banks that merged between 1997 and 2002 within that particular organization. Four weeks after the questionnaire was sent to the banks, the non-responding banks were contacted again with the request to cooperate. This resulted in responses from 81 banks, leading to a response rate of 77%. However, another 36 questionnaires were not used in the analyses: three banks were excluded because they misinterpreted our questions, twenty-nine respondents (eighteen in 2001, seven in 2002 and four in 2003) were excluded since it was not possible to obtain enough performance data and four questionnaires were filled in by someone other than the CEO. This lead to a final sample of 45 CEO's from banks that came into existed after the merger between two or three banks.

Measurement of variables

Post-merger performance

Post-merger performance is operationalized as bank productivity. Bank productivity is a common performance measure in the banking industry and is defined as the banking benefits divided by the costs. Banking benefits in this definition is the gross profit corrected for the interest revenues banks receive over their capital. The standard value for banking profitability

¹ Although the participating banks are all located in one country, their location is not revealed for reasons of anonymity.

provided by the central organization is 1,3 meaning that the banking benefits should be 30% higher than the costs of the bank.

Post-merger performance is evaluated over the three years after the merger and for each year the performance data published in December are used. The year in which the merger took place is the base year and is set as $t=0$. This means that if a bank merged in June 2000, the December performance data of 2000 is $t=0$. The first year after the merger is set as $t=1$, the second year as $t=2$ and the third year as $t=3$. In this way it is possible to compare the sample since the mergers took place in different years.

Insider and outsider CEO

An insider is defined as a former CEO or employee of one of the merging firms and is coded 1. An outsider is defined as someone coming from outside the merging firms and is coded 0.

Socio-cultural integration

Socio-cultural integration is measured as the perceived success of the socio-cultural integration by the CEO. This was not asked directly, but was determined based on the answers to an open-ended question on what went right and what went wrong in the post-merger context. All answers and the associated value judgments with respect to people and cultural aspects were then grouped. If the CEO perceived the process of socio-cultural integration to be successful, it was coded 1, if it was perceived as unsuccessful it was coded 0.

Internal environment

The internal environment was operationalized by assessing the perceived change in employee satisfaction, employee productivity, turnover and absenteeism. The CEO was asked to rate the perceived change since the administrative merger date on a 3 point scale: 1 representing a

decrease, 2 representing no change and 3 representing an increase. The answers of the CEO were then recoded into one internal environment score. If three or more internal environment variables changed in a positive direction, the internal environment was coded 1 signalling an improvement. If less than three variables increased, the internal environment was coded 0 indicating no improvement.

Results

First of all, the descriptive statistics for all variables were analyzed. The distribution of the number of merger firms, insiders and outsiders is presented in Table 1.

INSERT TABLE 1 ABOUT HERE

Table 2 presents the descriptive statistics and Spearman correlations for the relevant variables.

INSERT TABLE 2 ABOUT HERE

The correlation between socio-cultural integration and post-merger performance is positive and significant for bank profitability in years two and three after the merger. These results provide strong support for hypothesis 1 which predicted that as time progresses, successful socio-cultural integration and post-merger performance are positively related. The lack of significant results for year 1 can be explained by the time it takes to successfully establish socio-cultural integration (Quah and Young, 2005; Rowe et al., 2005).

Hypothesis 2 predicted that as time progresses, an improvement in the internal working environment and post-merger performance would be positively related. The results also provide support for this hypothesis as in year three after the merger there is a positive

correlation between bank profitability and an improvement in the internal working environment. The time effect suggested in the hypothesis is thus also present here.

Hypothesis 3 argued that successful socio-cultural integration is positively related to an improvement in the internal environment. This hypothesis is tested by looking at the correlation between socio cultural integration and the different components of the internal environment. The results show that only one component of the internal environment is significantly correlated with socio-cultural integration. Apparently successful integration goes hand in hand with increasing employee productivity, but not with the other elements.

The next analysis explores whether the origin of the new CEO makes a difference for the relationships between socio-cultural integration, improvements in the internal environment and post-merger performance. Mann-Whitney tests are used to analyze whether the mean scores of the insider CEO's differ significantly from those of outsider CEO's on the proposed relationships. The results are presented in Table 3.

INSERT TABLE 3 ABOUT HERE

Since none of the test turned out to be significant, there appears to be no difference in the proposed relationships in hypotheses 4 to 6 between insider and outsider CEO's. Hypotheses 4 to 6 are thus rejected.

Discussion and conclusion

This paper has analyzed two related questions with respect to leadership in a post-merger context. The first question addressed *what* a leader should manage to successfully manage post-merger performance. The second question referred to *who* should manage it. Overall, our

results suggest that *what* is being managed is more important in relation to post-merger performance than *who* manages it.

Specifically, our findings reveal that a leader should first and foremost focus on socio-cultural integration. Creating a new structure, managing the change process, retaining and motivating key employees, communicating with the diverse stakeholders are among the key tasks to engage in (Schuler and Jackson, 2001). Furthermore, following the argument put forward by Rowe et al (2005), the positive correlation with post-merger performance only occurs after a reasonable amount of time has elapsed. In line with findings from the organizational learning literature (Crossan et al., 1999) this suggests that the leader as well as the organizational members need time to develop and learn skills that are specific to the new organization. In the context of the generally short honeymoon period new CEO's get to prove themselves (Greiner et al., 2003), this finding has interesting managerial implications.

Our findings furthermore indicate that the leader should work on improving the internal working environment. Here it takes longer, however, before a significant positive relationship with performance emerges. The time effect as suggested by Rowe et al. (2005) is indeed also present here. Although, unfortunately no data are available to explain the dynamics behind the time effect, this would be an interesting avenue for future research.

Another implication arising from our results is that the leader should pay attention to both, socio-cultural integration and the internal working environment and not assume that managing one automatically leads to the other. Our results indicate that that is not the case. Surprisingly, socio-cultural integration was only associated with improved employee productivity and not with any of the other components of the internal working environment. Although the finding with respect to the relationship between employee productivity and socio-cultural integration is consistent with previous studies (Schuler and Jackson, 2001), the lack of significant correlations with the other components is still surprising. As socio-cultural

integration was not further specified in this study, future research should address this issue to be able to translate our findings into operational suggestions for newly appointed leaders in recently merged firms.

Finally as to the question who should manage post-merger process, our results show that it makes no difference whether an insider or outsider CEO performs the job. These findings yield support for the view that the choice of successor type is more a political process than a serious performance issue (Lin and Li, 2004). Although the appointment of an outsider might signal a certain strategic direction to the diverse stakeholders in the merger or might bypass internal political processes, there is no significant post-merger performance difference compared to insider CEO's. The managerial implications for the leader selection process are that post-merger performance benefits when people skills are valued over politics. If the leader subsequently also gets enough time to work on successful socio-cultural integration along with improvements in the internal working environment, changes increase to indeed beat the high merger failure rate statistics.

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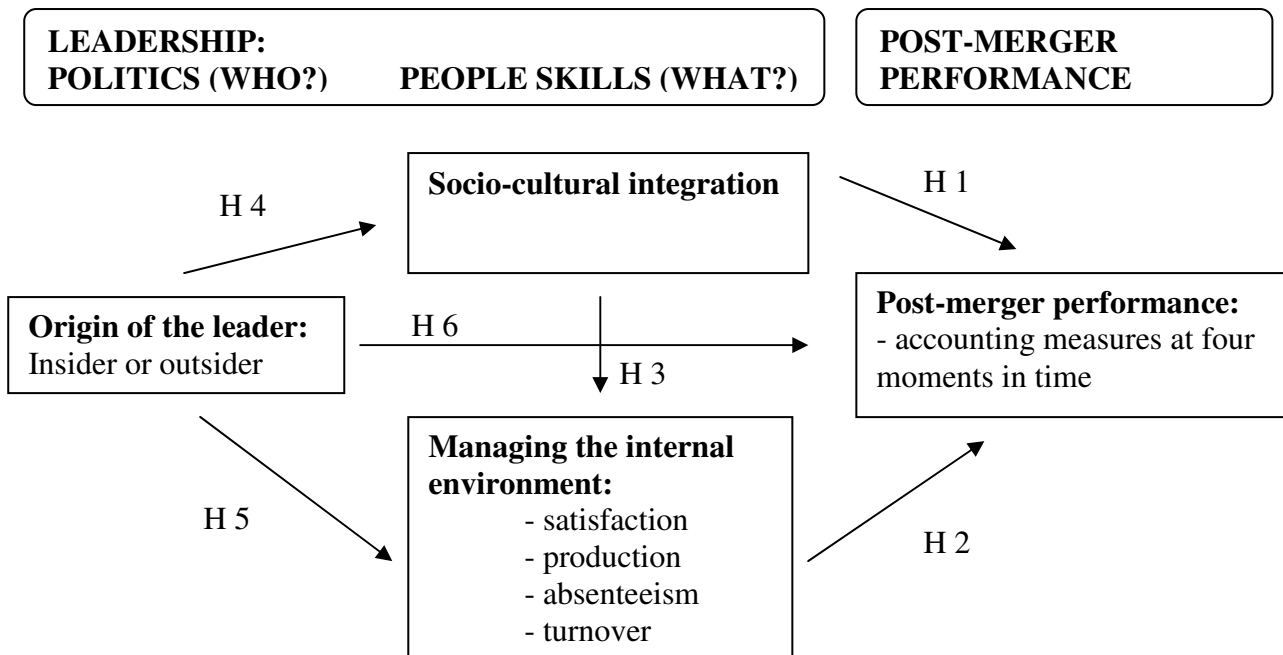
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Figure 1: Overview of the relationships studied between leadership and post-merger performance



<i>Year</i>	<i>Merged banks (n)</i>	<i>Outsider CEO (n)</i>	<i>Insider CEO (n)</i>
1997	6	1	5
1998	15	3	12
1999	12	2	10
2000	12	1	11

Table 1: Distribution of number of mergers, outsider and insider CEO's over the years

Variables	Mean	Sd	N	Correlations					
				(1)	(2)	(3)	(4)	(5)	(6)
(1) Socio-cultural integration	0.594	0.499	32	-	-	-	-	-	-
(2) Employee satisfaction	0.580	0.499	45	0.279	-	-	-	-	-
(3) Employee productivity	0.644	0.484	45	0.403**	0.305**	-	-	-	-
(4) Turnover	0.910	0.288	45	0.072	0.049	0.257*	-	-	-
(5) Absenteeism	0.560	0.503	45	-0.115	-0.131	-0.104	0.035	-	-
(6) Internal environment	0.244	0.424	45	-	-	-	-	-	-
(7) Bank profitability t=0	1.263	0.126	45	0.190	-	-	-	-	-0.064
(8) Bank profitability t=1	1.268	0.139	45	0.168	-	-	-	-	0.120
(9) Bank profitability t=2	1.282	0.152	45	0.314*	-	-	-	-	0.162
(10) Bank profitability t=3	1.270	0.153	45	0.624***	-	-	-	-	0.261*

Note: * correlation significant at the 0.1 level, **correlation significant at the 0.05 level, ***correlation significant at the 0.01 level (two-sided).

Table 2: Descriptive statistics and correlations

<i>Variables</i>	<i>Mann Whitney U (insiders versus outsiders)</i>	<i>Level of significance (2- tailed)</i>
Socio-cultural integration	48	0.776
Employee satisfaction	130,5	0.928
Employee productivity	99.5	0.206
Turnover	119	0.374
Absenteeism	132	0.971
Bank profitability t=0	101	0.331
Bank profitability t=1	96	0.259
Bank profitability t=2	116	0.631
Bank profitability t=3	123.5	0.771

Table 3: Results of Mann Whitney tests between the insider and outsider CEO's